

Volunteer Quality Alert 2006-01 – General Sales Tax Deduction

The instructions in TaxWise software, Sales Tax Worksheet, line 8 are inaccurate. Universal Tax Systems, developer of TaxWise software, will include corrected instructions for this form with the next Major update. Distribute this job aid or its message to volunteers assisting taxpayers.

State and Local General Sales Tax Deduction

For 2005, taxpayers may elect to either deduct state and local income tax paid or general state and local sales taxes paid. If they elect to deduct the general state and local sales taxes paid, they may claim the total amount paid by substantiation with receipts, or the amount from IRS tables plus the amounts of general state and local sales taxes paid on the purchase of a motor vehicle, boat, or other items to be determined by the IRS.

While this deduction will mainly benefit taxpayers with a state or local sales tax but no income tax, i.e. Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming, it may give a larger deduction to any taxpayer who paid more in sales taxes than income taxes.

Actual Expenses versus Optional Sales Tax Tables

Actual Expenses

Generally, a taxpayer can deduct the actual state and local general sales taxes if the tax rate **was the same** as the general sales tax rate. **Exception:** Sales taxes on food, clothing, medical supplies, and *motor vehicles are deductible **even if the tax rate was less than** the general sales tax rate. To use the actual method the taxpayer must keep actual receipts showing the general sales taxes paid.

***Motor vehicles** sales taxes are deductible **as** a general sales tax **even if the tax rate is more than** the general sales tax rate, but **only up to** the amount of tax that would have been at the general sales tax rate. Motor vehicles include cars, motorcycles, motor homes, recreational vehicles, sport utility vehicles, trucks, vans and off-road vehicles, **purchased or leased**.

- **Example:** The taxpayer bought a car for \$20,000 and paid \$1,200 of sales tax. The sales tax rate was 6% on the car, but the general sales tax rate on other items is 5%. You can deduct only \$1,000 of the \$1,200 of sales tax paid (i.e., the amount that would have been paid at the 5% rate) under the special rule for motor vehicles.

Optional Sales Tax Tables

The taxpayer can use the Optional Sales Tax Tables to figure his or her state and local general sales tax deduction. If this method is used, the taxpayer should complete the State and Local General Sales Tax Deduction Worksheet found in the 2005 Instructions for Schedules A & B (Form 1040).

The tables give taxpayers a sales tax deduction amount as an alternative to saving their receipts throughout the year and tabulating the amount actually paid. Taxpayers use their income level and number of exemptions to find the sales tax amount for their state. The table instructions explain how to add an amount for local sales taxes if appropriate.

Taxpayers also **may add to** the table amount any sales taxes paid on:

- A motor vehicle, but only up to the amount of tax paid at the general sales tax rate; and
- An aircraft, boat, home (including mobile or prefabricated), or home building materials, if the tax rate is the same as the general sales tax rate.

Aircrafts or boats sales taxes are deductible as general sales taxes if the tax rate **was the same** as the general sales tax rate.

- **Example:** The taxpayer bought a boat for \$20,000 and paid \$1,200 of sales tax. The sales tax rate was 6% on the boat, but the general sales tax rate on other items is 5%. You cannot deduct any of the sales tax paid on the boat because the 6% rate is higher than the general sales tax rate of 5%. The special rule for motor vehicles does NOT apply to boats.

A home (including a mobile home or prefabricated home) or substantial addition to or major renovation of a home sales taxes are deductible as general sales taxes, but only if the tax rate **was the same** as the general sales tax and **any** of the following applies:

1. if a state or locality imposes a general sales tax directly on the sale of a home, or substantial addition, or major renovation
2. if materials to build a home, or substantial addition, or major renovation were purchased and sales taxes were paid directly when the materials were purchased
3. if under state law, the contractor is considered the taxpayer agent in the construction of the home, or substantial addition, or major renovation

Publication 678, 2005 Volunteer Student Guide, refers volunteers to Publication 600, Optional State Sales Tax Tables, for more information. The IRS is not issuing Publication 600 for tax year 2005. Instead, volunteers should refer to the 2005 Instructions for Schedules A&B (Form 1040).

If a return has been prepared, and based on the information above is inaccurate, you should contact the taxpayer to amend their 2005 tax return.